

The Honorable Tana Lin

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
SEATTLE DIVISION

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

ISHAN WAHI, NIKHIL WAHI, AND
SAMEER RAMANI,

Defendants.

Case No. 2:22-cv-01009-TL

**BRIEF FOR AMICUS CURIAE
PARADIGM OPERATIONS LP**

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INTERESTS OF AMICUS CURIAE

Paradigm Operations LP (“Paradigm”) is an investment firm that backs innovative crypto companies and protocols. Issues placed before this Court have the potential to dramatically impact the design and operation of crypto companies and protocols. Paradigm seeks leave to participate in this case because it is concerned that a decision adopting the Securities and Exchange Commission’s (“SEC”) expansive and unsupported application of the *Howey* test, without appreciating its impact, could have sweeping and unintended effects on Paradigm and many others who seek to utilize new technology in a way that could benefit millions of users in the United States and around the world.

SUMMARY OF ARGUMENT

The SEC’s attempt to assert jurisdiction over the Defendants’ secondary trading of nine crypto assets identified in the Amended Complaint (the “Tokens”) by claiming that “these crypto assets were investment contracts,” (Amended Complaint dated December 22, 2022, ECF No. 27 (the “Amended Complaint”) at ¶100) is not supported by the facts or the law. The SEC incorrectly asserts that, because the Tokens were initially offered and sold in *transactions* that purportedly fell within the definition of “investment contract” as set forth by the Supreme Court in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946) (“*Howey*”), the Tokens themselves *became* “investment contracts”, a type of security included in the definition of that term in the Securities Exchange Act of 1934, as amended (the “Exchange Act”). *See* 15 U.S.C. §78c(a)(10). However, this is not how *Howey* has been applied over its 75-year history – and, as discussed below, that is for good reason.

As an initial matter, the Tokens themselves do not intrinsically have the characteristics of any type of “security” as defined in the Securities Act of 1933 (the “Securities Act”) or the

1 Exchange Act (the Exchange Act, together with the Securities Act, the “Securities Acts”). *See*
 2 15 U.S.C. § 77a *et seq.*; 15 U.S.C. § 78a *et seq.* That is, these nine Tokens, examined on their
 3 own without considering extrinsic factors, such as the manner in which the assets were initially
 4 sold, distributed, or promoted, do not purport to convey an interest in any person or entity or to
 5 create or represent any cognizable legal agreement and thus would not otherwise be considered
 6 securities. This can be seen from an examination of the computer code used to create these
 7 assets (known as “smart contract code”).¹

8 Recognizing this, the SEC focuses on factors extrinsic to the nature of the Tokens,
 9 devoting much of the Amended Complaint to alleging that these assets were used by promoters
 10 in fundraising schemes that they consider investment contract transactions. Based on the thinly
 11 supported allegations that the original investment schemes are “ongoing” (in ways not clearly
 12 specified in the Amended Complaint), the SEC asks the Court to accept the novel idea that these
 13 Tokens are securities for only so long as they are deemed to “embody” an ongoing investment
 14 scheme (which we refer to as the SEC’s “embodiment theory”), making them effectively
 15 *temporary* securities.² The Court should not endorse this unjustified expansion of securities law.

17 Moreover, because there are no allegations in the Amended Complaint that ownership of
 18 any of the Tokens creates any *legal relationship* between the owner of one or more of these
 19 assets and any other person or entity, adopting the SEC’s embodiment theory would require the
 20

21 ¹ See Exhibit 1 for the annotated smart contract code for one of the Tokens that uses the ERC-20 token standard.
 22 As is evident, the code alone does not create an interest in any entity or legal right against, or undertaking of, any
 23 entity.

24 ² This position is explicitly stated by the SEC in a filing in another case, *S.E.C. v. Ripple Labs, Inc.*, No. 20-cv-
 25 10832 (AT) (SN) (S.D.N.Y.) (“*Ripple Labs*”), which is currently pending outside this Circuit. *See Ripple Labs*, Pl.
 Mem. of Law in Opp’n to Mot. to Intervene, ECF No. 153 at p. 24 (where the SEC acknowledged that the purported
 security in the case is not “simply” the crypto asset at issue, known as XRP, and instead asserted that the crypto
 asset is the “embodiment” of the facts, circumstances, promises, and expectations that constitute the purported
 investment contract and therefore that XRP represents the purported investment contract). No judicial authority was
 cited for this proposition.

1 Court to endorse the concept of “issuer-independent” securities – securities whose existence is
 2 not linked to a single identifiable issuer.³

3 An identifiable issuer-owner relationship is critical to the analysis underlying the
 4 Amended Complaint; however, because third-party market participants, like the Defendants,
 5 must be able to practicably ascertain whether the asset they are selling or purchasing is a
 6 security. Yet under the SEC’s embodiment theory, transactions with tokens could be considered
 7 securities transactions without (i) a defined set of rights or obligations set out in a legal
 8 instrument (not alleged in the Amended Complaint) or (ii) the presence of an identifiable legal
 9 relationship between an “issuer” (within the meaning of the Exchange Act) and the owner of the
 10 asset (not alleged in the Amended Complaint with respect to the Defendants).⁴

11
 12 As a result, without a legal agreement to review or a business relationship to evaluate, the
 13 Defendants, and all other market participants transacting in the Tokens are left to guess at
 14 whether a court would conclude that one or more of the Tokens does, or does not, “embody” an
 15 ongoing investment scheme at any given time they transact. This inevitable uncertainty would
 16 leave the Defendants and all parties transacting in one of the Tokens potentially responsible for
 17 compliance with the federal securities laws as a broker, a dealer, a national securities exchange,
 18

19
 20 ³ For example, the legal entity that deployed the original smart contract code that created the Token and/or the
 21 legal entity (or entities) that initially sold a Token to raise funds could subsequently dissolve in a legally appropriate
 22 manner and the Token (*i.e.*, the ledger entry recorded in the relevant blockchain network) would continue to exist.
 This is not possible with any other type of security known to federal securities law where, if the specific entity that
 is the “issuer” of the security dissolved, the security would continue to exist in a legally cognizable sense.

23 ⁴ In all of the appellate cases in this Circuit where an investment contract transaction was found to be present, there
 24 has always been an identifiable business relationship (and, in almost all federal appellate cases, an actual legal
 25 agreement) between the party alleged to have created or promoted the relevant investment scheme and the person or
 entity that provided the “investment of money” required by *Howey*. This business or contractual relationship with
 the promoter of the scheme or investment allows the person or entity making the investment of money to have
 access to the information needed to determine whether they are engaging in a securities transaction, including
 private information.

1 an investment advisor or investment company, or otherwise without an ability to definitively
2 determine whether they are transacting in a token that “embodies” an investment contract.

3 Even taking into account the broad remedial purposes of federal securities laws,
4 embracing the embodiment theory would be neither an appropriate nor an effective extension or
5 modernization of the *Howey* jurisprudence as a matter of public policy. And, certainly, such a
6 deviation from current law should not be imposed retrospectively on the Defendants.
7 Essentially, the SEC seems to suggest that market participants should simply assume that the
8 Tokens and, based on public statements made by the SEC’s Chair and other senior officials of
9 the SEC,⁵ virtually *all* crypto assets, are securities until the SEC tells them otherwise, a power
10 not granted to the SEC by the Congress.⁶

11 ARGUMENT

12 **I. THE TOKENS ARE NOT “SECURITIES” UNDER ANY CURRENTLY** 13 **RECOGNIZED APPLICATION OF THE SECURITIES ACTS.**

14 **A. In the Absence of Extrinsic Factors, the Tokens Are Not Inherently or** 15 **Intrinsically Securities**

16 Examined independently from any extrinsic factors, such as the manner in which they
17 were sold, distributed or promoted, the Tokens are simply ledger entries (numbers) maintained
18

19 ⁵ See, e.g., Ankush Khardori, “Can Gary Gensler Survive Crypto Winter? D.C.’s top financial cop on Bankman-
20 Fried blowback”, New York Mag. (Feb. 23, 2023), available at: <https://nymag.com/intelligencer/2023/02/gary-gensler-on-meeting-with-sbf-and-his-crypto-crackdown.html> (in which Chair Gensler is quoted as stating that
21 “everything other than bitcoin” is a security because “there’s a group in the middle and the public is anticipating
22 profits based on that group.”); see also Gary Gensler, “Kennedy and Crypto”, Speech (Sept. 8, 2022), available at:
23 <https://www.sec.gov/news/speech/gensler-sec-speaks-090822> (“Of the nearly 10,000 tokens in the crypto market, I
24 believe the vast majority are securities”); see also Gary Gensler, “A ‘New’ New Era,” Prepared Remarks Before the
International Swaps and Derivatives Association Annual Meeting (May 11, 2022), available at:
25 <https://www.sec.gov/news/speech/gensler-remarks-swaps-and-derivatives-association-annual-meeting-051122>
(expressing the view that “[w]ithout prejudging any one [crypto] token, most crypto tokens are investment contracts
under the Supreme Court’s *Howey* Test.”).

⁶ It should be noted that *amicus* expresses no view as to whether the individuals or entities that offered or sold
these assets violated the federal securities laws at any point; we address only the question of whether the facts
alleged in the Amended Complaint support a finding that the Defendants engaged in securities transactions.

1 by a network of computers operating a common protocol. This is shown through an examination
 2 of a representative sample of the smart contract code that created the Tokens. *See* Exhibit 1.⁷

3 It is possible that a token created and sold by a company could be paired with a legally
 4 recognized interest in, or an enforceable agreement of, that company. In such a case, it would be
 5 this interest or agreement that would constitute the “security”. For example, a company could
 6 expressly designate a given token as the means by which an owner of the token could evidence
 7 its ownership interest in the company or enforce a traditional legal agreement against the
 8 company.⁸ In this way, the token would theoretically function similarly to a stock or bond
 9 certificate.

10 However, none of the Tokens are alleged to be associated with a legally recognized
 11 interest in any company nor do they create any enforceable legal right for the benefit of the
 12 owner against any third party. Rather, the Amended Complaint relies on a range of vague
 13 statements made by persons presumed to be associated with the companies or unincorporated
 14 businesses that initially sold the tokens. For example, XY Labs, Inc., a company associated with
 15 the development of the XY token, is alleged to have posted a “roadmap” with target dates for the
 16 development of the XYO Network. Amended Complaint, at ¶149. However, it is not alleged
 17 that this “post” was intended to create a binding obligation of XY Labs to meet this roadmap,
 18
 19

20 ⁷ For a more in-depth look at how crypto assets in general are created (“minted”), transferred, and destroyed
 21 (“burned”), *see* David J. Kappos, Lee A. Schneider, Daniel M. Barabander, & Callum A.F. Sproule, “Fuzzy
 22 Tokens: Thinking Carefully about Technical Classification Versus Legal Classification of Cryptoassets,” available
 23 at https://btj.org/wp-content/uploads/2023/03/Kappos_WebFile_02-28-23.pdf

24 ⁸ For an example of a company intentionally associating a crypto asset with a specific legal promise, *see*
 25 Amendment 11 to INX Limited Registration Statement on Form F-1 (“each INX Token held by parties other than
 the Company, shall entitle its holder to receive a Pro Rata Portion ... of an aggregate amount which equals 40% of
 our cumulative Adjusted Operating Cash Flow, net of Adjusted Operating Cash Flows that have already formed a
 basis for a prior distribution”) available at
[https://www.sec.gov/Archives/edgar/data/0001725882/000121390020023078/ea125736-
 f1a11_inxlimited.htm#a_014](https://www.sec.gov/Archives/edgar/data/0001725882/000121390020023078/ea125736-f1a11_inxlimited.htm#a_014).

1 enforceable by holders of the XY token. Rather, the post can at most be alleged to create general
 2 expectations on the part of future purchasers of the XY tokens, a concept which is discussed
 3 below.

4 These and other statements set out in the Amended Complaint may be sufficient to allow
 5 a court to conclude that the various fundraisings utilizing the Tokens were “investment contract
 6 transactions” (discussed below), but they do not establish that these assets are themselves
 7 intrinsically “securities” by reference to an identified interest or agreement. As a result, other
 8 than potentially being offered and sold as part of an “investment contract”, the Tokens do not fall
 9 within any of the other enumerated types of “security” in the Securities Acts.
 10

11 B. The Tokens Themselves Are Not Securities Because They May Have Initially
 12 Been Sold in Investment Contract Transactions.

13 **1. The Allegations in the Amended Complaint Are Only Relevant to the**
 14 **Question of Whether the Tokens Were Initially Sold in Investment Contract**
 15 **Transactions.**

16 The Amended Complaint focuses on the actions of the persons or entities that acted as
 17 “promoters” of the Tokens, noting that each of the Tokens “were offered and sold by an issuer to
 18 raise money that would be used for the issuer’s business”. Amended Complaint, at ¶101. Under
 19 current law, a “scheme” to fundraise by offering an asset that is not otherwise a security (a “non-
 20 security asset”, whether it be animals being grown for their pelts, whiskey aging in barrels, or a
 21 crypto asset), together with some accompanying undertakings on the part of the fundraising
 22 entity to increase that asset’s value over time or to produce income from the asset when made to
 23 a person with no “consumptive interest” in that asset will be an investment contract transaction.
 24
 25

1 *See Howey*, 328 U.S. at 299-300.⁹ In *Howey*, the Supreme Court evaluated whether the
 2 circumstances of a given *contract, transaction or scheme* involves: (1) an investment of money
 3 (2) in a common enterprise (3) with an expectation of profits to come (4) solely¹⁰ from the efforts
 4 of the promoter or a third party. *See id.* at 298.

5 The Supreme Court and Ninth Circuit appellate courts have consistently noted that
 6 whether an investment contract scheme is present will be based on all of the facts and
 7 *circumstances* involved.¹¹ However, the Amended Complaint provides relatively brief and
 8 selective descriptions of the activities purportedly giving rise to the underlying investment
 9 contract transactions that are supposedly “embodied” by the Tokens.¹² For example, in an
 10 attempt to show that purchasers of Amp tokens from Flexa invested in a “common enterprise”,
 11 the SEC alleges that the Amp token can be staked in collateral pools to secure the network and
 12 that “[i]f the collateral pools are profitable, investors who stake Amp can share in the profits”.
 13 Amended Complaint, at ¶114. Yet the Amended Complaint does not present any details as to
 14 how many holders staked Amp, the amount of profit they earned, those purchasers’ reasons for
 15

17 ⁹ In a much smaller number of cases under *Howey*, there is an unusual legal instrument that sets out certain rights
 18 or interests conveyed to an owner but which does not fall clearly within any of the other enumerated categories in
 19 the definitions of “security” in the Securities Acts. Examples include a flexible fund annuity offered by an insurance
 20 company to its customers (*S.E.C. v. United Benefit Life*, 387 U.S. 202 (1967)), and nonnegotiable capital shares in a
 state-chartered savings and loan association (*Tcherepnin v. Knight*, 389 U.S. 332 (1967)). However, none of the
 Tokens belong to this type of investment contract arrangement.

21 ¹⁰ This standard has been modified in subsequent decisions to no longer require that the efforts made are “solely”
 from the others involved in the scheme, however this distinction is not material to the arguments made in this brief.

22 ¹¹ *See, e.g., Landreth Timber Co. v. Landreth*, 471 U.S. 681, 689 (1985) (“an unusual instrument could be
 considered a “security” if the circumstances of the transaction so dictated.”)

23 ¹² The facts alleged with respect to each of the nine Tokens in the Amended Complaint run between approximately
 24 three pages to approximately six pages in length. In contrast, the SEC’s complaint against LBRY, Inc. alleging sales
 of crypto assets in violation of Section 5 of the Securities Act ran 16 pages and the SEC’s first amended complaint
 25 on a similar theory against Ripple Labs, Inc. and two of its senior executives ran 79 pages. *See S.E.C. v. LBRY, Inc.*,
 D.N.H. Case No. 1:21-CV-00260 D.E. 1 (March 29, 2021), and *S.E.C. v. Ripple Labs, Inc. et al.*, No. 20-10832
 (S.D.N.Y. Dec. 22, 2020), ECF No. 4.

1 acquiring Amp, or whether they had other strategic reasons for participating in the network.
 2 Likewise, we are told that 20% of Amp’s predecessor token was allocated to the founding team
 3 and an employee pool. *See* Amended Complaint, at ¶116. Yet the Amended Complaint fails to
 4 specify how many of the recipients stayed with Flexa or the extent to which their contributions
 5 were material to the success of the project (as opposed to, say, factors outside the control of these
 6 individuals) in order to support the allegation of a common enterprise.

7 In the absence of robust pleading, *amicus* believes that it is not possible to conclude that
 8 the allegations in the Amended Complaint are sufficient to support even the basic claim that the
 9 Tokens were *initially* sold pursuant to investment contract transactions.
 10

11 **2. Even If the Court Finds that the Allegations in the Amended**
 12 **Complaint Are Sufficient to Support a Claim that the Tokens Were Initially**
 13 **Sold by Promoters Pursuant to Investment Contract Transactions, the SEC**
 14 **Fails to Correctly Apply the *Howey* Test to the Defendants’ Specific**
 15 **Transactions.**

16 To the extent that the SEC wishes to allege that the Defendants’ purchases and sales of
 17 the Tokens were *also* investment contract transactions, under current law in the Ninth Circuit, all
 18 four *Howey* factors must be established *at the time each transaction took place*. This principle is
 19 illustrated in *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (*en banc*) (“Hocking II”), where
 20 the full Ninth Circuit analyzed a transaction under *Howey* that did not directly involve as a party
 21 the entity that would purportedly be the “issuer” of the alleged investment scheme (a real estate
 22 developer).¹³

23 In *Hocking II*, an individual investor looking for an income-producing property
 24 purchased a rentable condominium unit from the unit’s original purchasers in a secondary

25 ¹³ For a more detailed discussion of *Hocking II*, see Lewis Cohen et al., *The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets Are Not Securities* (Nov. 10, 2022) at pp. 58 – 61.

transaction based on information about the unit developer's rental scheme provided to Hocking by his broker, Dubois. When the deal went sour, Hocking sued his broker, alleging that the secondary sale was an investment contract transaction subject to the antifraud provisions of the Exchange Act in which the broker made misrepresentations. The District Court found that Hocking's transaction did not constitute an investment contract. *See Hocking v. Dubois*, 839 F.2d 560, 562 (9th Cir. 1988) ("Hocking") (describing trial court opinion), *modified on reh'g en banc*, 885 F.2d 1449 (9th Cir. 1989) (*en banc*). However, a tribunal of the Ninth Circuit reversed, finding that an "offering of a condominium with [a rental pool agreement] automatically makes the [transaction an investment contract]." *Id.* at 565. The SEC also took the highly unusual step of submitting an *amicus* brief to the court arguing that the facts in *Hocking* did not warrant the finding of an investment contract transaction. After a rehearing by the full Ninth Circuit, the outcome was reversed again, to find that the arrangement did not *automatically* constitute an investment contract transaction. Accordingly, the case was remanded back to the lower court for further fact finding. On rehearing, the *Hocking II* majority reasoned:

We agree with defendants and *amici* that the three-judge panel may have written too broadly its conclusion that so long as a rental pool 'option' exists, all secondary market sales necessarily involve a security. Such a *per se* rule would be ill-suited to the examination of the economic reality of *each transaction* required by *Howey*.

Hocking II, 885 F.2d at 1462 (emphasis added). Critically, the majority in *Hocking II* did not assume that because the purchase of the condominium and the rental pool agreement directly from the developer would have constituted an investment contract transaction, that the purchase of those same items in a transaction with a secondary seller through the broker should automatically be treated as an investment contract transaction as well. See *id.* at 1456. Rather, the majority's analysis relied on an application of the *Howey* test to the specific facts and

1 circumstances surrounding Hocking’s (secondary market) purchase of the condominium and the
 2 rental purchase agreement before them. Following *Hocking II*, this Court should dismiss the
 3 SEC’s Amended Complaint for its failure to plead allegations that the Defendant’s specific
 4 transactions in the Tokens met the definition of “investment contracts” at the time and in the
 5 context they took place.

6
 7 **3. Instead of Establishing that the Defendants’ Specific Transactions in**
 8 **the Tokens Meet the *Howey* Test, the Amended Complaint Inappropriately**
 9 **Alleges that these Assets Are Securities Because the Promoters’ Schemes Are**
 10 **“Continuing”.**

11 To correctly apply the *Howey* test to the Defendants’ transactions, the Amended
 12 Complaint would need to show how each of such transactions met all four prongs of the *Howey*
 13 test at the time they occurred – something that the Amended Complaint fails to do. Instead, the
 14 Amended Complaint alleges that facts which attempt to establish that the Tokens were sold by
 15 promoters in investment schemes that are “ongoing,” somehow resulting in the Defendants’
 16 purchases and sales separately constituting investment contract transactions. This is a
 17 misapplication of *Howey* that departs from all precedent.

18 Neither the Ninth Circuit nor any other federal appellate court has ever suggested that the
 19 object of the investment contract (*i.e.*, an asset, like the Tokens, that is not intrinsically a
 20 security), if transferred between unaffiliated third parties, in any way represents or “embodies”
 21 the underlying investment scheme. See Lewis Cohen *et al.*, *The Ineluctable Modality of*
 22 *Securities Law: Why Fungible Crypto Assets Are Not Securities* (“*Why Fungible Crypto Assets*
 23 *Are Not Securities*”) (Nov. 10, 2022), at pp. 55-58, attached as Exhibit 2. Rather than following
 24 75 years of accepted *Howey* jurisprudence by focusing its enforcement efforts on the actions of
 25 the persons it has identified as the promoters of investment schemes involving the Tokens, the

1 SEC's Amended Complaint instead seeks to apply the Exchange Act to the Defendants, who are
 2 third-party purchasers of the Tokens. This unsupported expansion of the Securities Acts shifts
 3 the burden of compliance from the persons who may have sold non-security assets to raise funds
 4 for a business without SEC registration to the third-party owners of these assets – the very
 5 persons the Securities Acts are intended to protect. *See* Amended Complaint, at ¶100.

6 The locus of the SEC's misreading of *Howey* in the context of secondary transactions in
 7 non-security assets, such as the Tokens, is the “common enterprise” element of the test. In
 8 fundraisings that are considered investment contract transactions, persons provide capital to the
 9 “enterprise” in exchange for some non-security asset that, generally, the purchaser has no
 10 consumptive interest in. The common enterprise exists due to the shared “investment of money”
 11 between the asset purchaser and the promoter. However, absent unusual facts not alleged in the
 12 Amended Complaint, secondary market purchasers of non-security assets initially sold in an
 13 investment contract transaction do not provide any funding to the relevant promoters and
 14 therefore cannot be said to be in a “common enterprise” with the promoter or other owners of the
 15 asset within the meaning of *Howey*.

17 In their analysis of each of the Tokens, the SEC attempts to establish the existence of a
 18 “common enterprise” primarily on the basis that the Token owners share a “common interest”
 19 with the alleged promoters. For example, “Amp investors share a common interest with Flexa's
 20 management team”. *See* Amended Complaint, at ¶116. “DerivaDEX and its management team
 21 retain the vast majority of the ‘emitted’ DDX token, creating a common interest between
 22 management and other investors”. Amended Complaint, at ¶138. However, this conclusion is
 23 mistaken. There are many examples where non-security assets are purchased partially or entirely
 24 for their profit potential and derive their value significantly from the purchaser's reasonable
 25

1 expectations of the actions of “others”. Absent some other relationship between the parties, this
 2 relatively familiar arrangement does not create a “common enterprise” between the asset
 3 purchaser and the “others” within the meaning of *Howey*. These include:

- 4 • A speculative buyer that made a secondary purchase of a parcel of real estate that
 5 was part of a larger development may reasonably expect the developer that owns
 6 many of the other nearby parcels to add features to the development that would
 7 increase the value of all of these parcels based on statements made in advertising
 8 brochures concerning the development published by the developer;
- 9 • A fund acquiring certain cartel-supported commodities (like diamonds or crude
 10 oil) for investment purposes may reasonably expect the relevant cartel (*e.g.*, De
 11 Beers or OPEC) to maintain production levels that support publicly announced
 12 unit price targets that would benefit both the buyer and the cartel members;
- 13 • A hobbyist collector/investor in children’s limited-edition plush dolls may see a
 14 social media post by the dolls’ manufacturer and reasonably expect a particular
 15 line of dolls to be discontinued by the manufacturer after a run of a certain
 16 volume, increasing scarcity and therefore price of the dolls, providing profit to the
 17 buyer and enhancing demand for future toys to be sold by the manufacturer;
- 18 • A purchaser of bitcoin might reasonably expect the declining market price of the
 19 asset to stabilize following the public statements of the CEO of a publicly traded
 20 technology company that the company would maintain their extensive holdings of
 21 bitcoin for the foreseeable future, providing an economic benefit to the purchaser
 22 and the public company.
 23
 24
 25

1 In none of these cases would a court in the Ninth Circuit have judicial precedent to find that the
 2 third-party asset buyer is in a “common enterprise” within the meaning of *Howey*. The fact that
 3 the buyer had a shared economic interest with the real estate developer, the commodities cartel,
 4 the doll manufacturer, or the public company, which had made public statements that could
 5 reasonably be interpreted as having a positive impact on the price of the asset is not sufficient to
 6 find a common enterprise.

7 To bolster the “common interest” argument, the Amended Complaint references a highly
 8 selective set of statements made by the parties that deployed the smart contract code creating the
 9 Tokens or otherwise sold these assets to others. However, not only is it not alleged that the
 10 Defendants were aware of these facts, in many cases the SEC’s alleged facts are not ones it
 11 would even be possible for the Defendants (or any other third party) to be aware of. For
 12 example, the statements “Rally ... applied to Coinbase to have RLY listed” (Amended
 13 Complaint, at ¶127); “DerivaDEX and its management team retain the vast majority of ‘emitted’
 14 DDX tokens” (Amended Complaint, at ¶138); “XY’s day-to-day operations and Board of
 15 Directors are run by a centralized leadership group that include [sic] two of XY’s three co-
 16 founders” (Amended Complaint, at ¶ 154) each contain non-public information.

17 Yet the Amended Complaint suggests that, as a matter of law in the Ninth Circuit, the
 18 Court should accept that the very brief periods of common ownership of the Tokens between the
 19 Defendants and the promoters of the various schemes associated with these assets, without any
 20 alleged contractual or other relationship between the parties or even allegations that the
 21 Defendants were aware of the facts alleged about these schemes, is sufficient to establish a
 22 “common enterprise” for purposes of *Howey*. Having cited limited evidence to support their
 23 assertion that the *initial* fundraising sales of the Tokens constituted investment contract
 24
 25

1 transactions, the SEC then completely fails to present any meaningful factual allegations to
 2 support the proposition that the Defendants’ secondary transactions in those assets are also
 3 investment contract transactions, instead making a cursory observation that “the hallmarks of the
 4 definition of a security” continue to exist “at all times relevant to the conduct alleged in [the
 5 Amended Complaint]”. Amended Complaint, at ¶105.

6
 7 **4. In light of the Fundamental Deficiencies with the Amended**
 8 **Complaint’s Traditional *Howey* Analysis, We Are Left with an Argument**
 9 **that, in Effect, the Tokens “Embody” the Original Promoters’ Alleged**
 10 **Investment Schemes and Thus “Become” Securities While these Schemes are**
 11 **Ongoing.**

12 The last way the SEC may seek to persuade the Court that the Tokens “are” securities
 13 (without having to establish how the Defendants entered into separate investment contract
 14 transactions) is by asserting that these assets “embody” the underlying investment schemes and
 15 thus are *temporary* securities for so long as the original scheme is “ongoing.” In *Ripple Labs*,
 16 despite citing no legal authority, the SEC took the position that the token, known as XRP,
 17 although not itself a security, function as the “embodiment” of the facts, circumstances,
 18 promises, and expectations that constitute the purported investment contract and therefore that
 19 the crypto asset *represents* the purported investment contract. *See Supra* fn. 2.

20 However, the SEC has not cited any case law for the proposition that an asset *that itself is*
 21 *not a security* can “evidence” an investment contract and thus become a temporary security,
 22 either in the Amended Complaint or, to the knowledge of *amicus*, anywhere else. In fact, a
 23 review of the case law in *Why Fungible Crypto Assets Are Not Securities* demonstrates that this
 24 is not something found elsewhere in the entirety of *Howey* appellate jurisprudence. Holding
 25 aside the merits of adopting the embodiment theory (discussed below), it would be wholly

1 inappropriate to allow charges to be brought against the Defendants based on a novel theory of
 2 the law of which the Defendants could not have had any knowledge.

3
 4 **II. THE SEC’S ATTEMPTED EXPANSION OF *HOWEY* JURISPRUDENCE**
 5 **WHICH WOULD EFFECTIVELY TREAT CRYPTO ASSETS AS SECURITIES**
 6 **BASED ON EXTERNAL FACTORS ON A TEMPORARY BASIS, IS**
 7 **UNFOUNDED, UNWORKABLE AND CONTRARY TO THE FUNDAMENTAL**
 8 **STRUCTURE OF THE FEDERAL SECURITIES LAWS, WHICH ASSUMES A**
 9 **LEGAL RELATIONSHIP BETWEEN AN ISSUER OF A SECURITY AND THE**
 10 **OWNER.**

11 The SEC has suggested that the “flexibility” of the *Howey* test should allow them to
 12 extend its scope to any circumstance in which it concludes that investor protection is required.¹⁴
 13 In order to capture secondary activity in most crypto assets within the jurisdiction of the SEC,
 14 the Amended Complaint stretches the Supreme Court’s reasoning in *Howey* and its progeny past
 15 its breaking point. The catch-all concept in the definitions of “security” in the Securities Acts,
 16 “investment contract”, has been used to bring *fundraising transactions* that elevate form over
 17 substance within the ambit of the federal securities laws. However, until now, the concept of
 18 “investment contract” has not been extended to activities of companies or individuals not directly
 19 or indirectly part of those fundraising transactions, and that is for good reason.

20 Market participants purchasing or selling an asset must be able to evaluate on their own
 21 whether the asset they transact in would be considered a security under the Securities Acts.
 22 Where the asset consists of an instrument that sets forth the rights and benefits that ownership of
 23 the asset conveys, market participants can conduct that analysis and reach a reliable conclusion.
 24 However, it is not reasonable to expect the Defendants or other purchasers of the Tokens to

25 ¹⁴ See, e.g., Gary Gensler, “Kennedy and Crypto”, Speech (Sept. 8, 2022), available at:
<https://www.sec.gov/news/speech/gensler-sec-speaks-090822> (stating, “[n]othing about the crypto markets is
 incompatible with the securities laws. Investor protection is just as relevant, regardless of underlying technologies.”)

1 attempt to locate the original sellers of the crypto assets (and, potentially, loosely affiliated
 2 entities or individuals), monitor their ongoing statements across all media and communication
 3 channels and their other potentially relevant activities (*e.g.*, public appearances) and make a
 4 determination on their own as to whether the original investment scheme is still “ongoing” and
 5 as such determine its status as a security.

6 It is also unclear how the Defendants or other purchasers of the Tokens should weigh
 7 different statements by different parties,¹⁵ and how these statements may (or may not) persuade a
 8 court that a “common enterprise” and the other elements of the *Howey* test are present. In the
 9 SEC’s view, it appears that as long as there are one or more entities that both own some
 10 (indeterminate) amount of the Token and are in any way promoting the benefits of the associated
 11 protocol on an “ongoing” basis, then these circumstances should be sufficient to create a
 12 “common enterprise” resulting in the crypto asset embodying the purportedly ongoing
 13 investment scheme. But, as discussed above, such an approach would not apply in similar
 14 circumstances in the case of real estate, crude oil, diamonds, plush dolls, or bitcoin – why should
 15 it apply to the Tokens? This approach would be wholly inconsistent with how statements with
 16 respect to other non-security assets made by third parties are viewed – even where there is a
 17 shared economic interest among owners of the asset in question.
 18

19 The embodiment theory inherently conflicts with a basic assumption of the federal
 20 securities laws: that all securities will have an “issuer”—an identifiable person or entity that
 21 creates the security and against whom a securityholder’s rights can be exercised. Each type of
 22 security enumerated by Congress in the Securities Acts, other than “investment contracts” which
 23

24
 25 ¹⁵ For example, if a statement is made in a blog post is that more relevant than a statement made in a tweet? What if there are contradictory or apparently superseding statements made by different persons working on a project? How should statements made by person no longer actively involved in a project be weighed?

1 are defined by case law, of necessity involves a *legal relationship* volitionally established by an
 2 identifiable legal entity that acts as the *issuer* of the security and the various other parties who,
 3 from time to time, are *owners* of that. This legal relationship can be determined by third parties
 4 through an examination of a legal instrument – the “security” – with obligations on the part of
 5 the issuer that are readily discernible from an examination of the written documentation.

6 If the Court were to adopt the embodiment theory, it would present insurmountable
 7 difficulties for market participants in the U.S. seeking to buy, hold or sell crypto assets. Neither
 8 the Defendants nor any other purchaser of a Token in a secondary market transaction has any
 9 way of knowing or determining all of the “facts, circumstances, promises, and expectations” that
 10 might be deemed by a court reviewing the circumstances in hindsight to be “embodied” in any
 11 given crypto asset. Moreover, many of these circumstances relevant to a *Howey* analysis may
 12 not be matters of the public record or capable of discovery by third parties who lack the SEC’s
 13 subpoena power.
 14

15 To make matters even more complicated, in such circumstances, courts do not rely solely
 16 on the contractual agreements between the parties to evaluate whether the arrangement
 17 constituted an investment contract transaction or scheme, a point driven home in this Circuit by
 18 the SEC themselves.¹⁶ As a result, even if the Defendants or other persons transacting in the
 19 Tokens had access to all relevant documents and public statements about the assets and the
 20 related protocol, other non-public actions or statements could be deemed to supersede the public
 21 information concerning the assets and the promoters available to the Defendants.
 22

23
 24 ¹⁶ In the SEC’s *amicus curiae* brief filed in *Salameh, et al. v. Tarsadia Hotel et al.*, 726 F.3d 1124 (9th Cir. 2013),
 25 a case involving purchases of condominiums in the Hard Rock Hotel San Diego alleged to be a disguised securities
 transaction by the plaintiffs, they write that the district court “placed dispositive weight on these representations [in
 the Purchase Contract] and, in doing so, failed to fully consider the broader realities of the overall transaction.” Br.
 of *Amicus Curiae* SEC at 16-17.

1 In addition, to correctly apply the *Howey* test, a party would have to make its evaluation
 2 *each and every* time a specific transaction takes place when the facts and circumstances could be
 3 constantly changing and third parties seeking to own, use and transfer crypto assets do not have
 4 the economic resources or incentive to constantly monitor this information. As demonstrated by
 5 the research undertaken in *Why Fungible Crypto Assets Are Not Securities*, it is hardly a “fact”
 6 that each and every time a specific transaction takes place, the transaction is a securities
 7 transaction. Indeed, in totality, of the 253 relevant federal appellate decisions reviewed, a
 8 majority (56%) of those relevant disputes end either in a conclusion by the court that no
 9 investment contract was present and thus that the Securities Acts should not apply to the
 10 transaction (42%), or remand for further fact-finding (12%). More specifically, the Ninth
 11 Circuit, which has thus far been responsible for 27% of all federal appellate investment contract
 12 cases, has found that an investment contract was not present, or remanded for further
 13 proceedings, in 53% of all of its decisions, thus highlighting that a *Howey* analysis is particularly
 14 challenging to get right. Implementing the embodiment theory would present insurmountable
 15 difficulties for market participants to evaluate all the applicable facts and circumstances on their
 16 own, or risk strict liability violations of the Securities Acts.

18 CONCLUSION

19 There is no basis in current law to classify the Tokens as “investment contracts” when
 20 purchased and sold by the Defendants because these crypto assets are not themselves securities
 21 and the Defendants’ purchases and sales of the Tokens would not be properly characterized as
 22 investment contract transactions under current interpretations of the *Howey* Test in the Ninth
 23 Circuit. In addition, there is no current jurisprudential authority for asserting that the Tokens
 24 somehow “embody” an ongoing investment scheme being undertaken by parties unrelated to the
 25

Defendants. The SEC ignores the correct application of *Howey* to each *transaction* and instead, attempts to create a *de facto* presumption that most, if not all, crypto assets are themselves investment contracts despite the fact that there is no legal or logical basis for such a presumption. This approach is untethered from the powers conferred on the SEC by Congress.

For the aforementioned reasons, the SEC has not met its burden of alleging facts sufficient to establish that the Defendants entered into securities transactions, requiring the Court to grant the Defendants' Motion to Dismiss.

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